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C O N F I D E N T I A L SECTION 01 OF 02 KATHMANDU 002210

SIPDIS

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TAGS: [EPET](#) [ENRG](#) [ECON](#) [ETRD](#) [EFIN](#) [PGOV](#) [PREL](#) [NP](#)

SUBJECT: NEPAL FACES LOOMING CRISIS IN PETROLEUM SUPPLY

REF: A. KATHMANDU 01818

[1](#)B. KATHMANDU 00374

[1](#)C. KATHMANDU 00070

Classified By: Ambassador James F. Moriarty; Reasons 1.4 (b/d).

SUMMARY

[1](#)1. (SBU) The state-owned monopoly oil importer, the Nepal Oil Corporation (NOC), is experiencing a serious financial crisis. Unable to collect payment of the balance owed by NOC, the NOC's supplier, Indian Oil Corporation (IOC), has threatened to stop providing petroleum products to Nepal. The Ministry of Finance and the central bank of Nepal came to NOC's rescue in September after commercial banks refused to pledge any fresh loans to NOC, despite requests from Assistant Finance Minister Roop Jyoti. Because the government continues to subsidize the price of petroleum products in Nepal, the NOC incurs a loss of roughly USD 7 to 10 million every month. NOC reportedly lost more than USD 112 million in the last year. Experts in government and civil society believe that His Majesty's Government of Nepal (HMGN) must develop a market-based pricing mechanism and remove subsidies to solve the problem. END SUMMARY.

NEPAL OIL CORPORATION IN DIRE FINANCIAL CRISIS

[1](#)2. (SBU) The state-owned monopoly oil importer NOC is experiencing a serious financial crisis due to the huge monthly losses it incurs as a result of selling petroleum products at a subsidized price. Upon failing to collect payment of USD 31.34 million from NOC for the month of September, Nepal's supplier, IOC, threatened to stop providing petroleum products to Nepal. The Ministry of Finance (MOF) and Nepal Rastra Bank (NRB), the central bank of Nepal, bailed out NOC at the eleventh hour by lending the equivalent of USD 17.5 million from the government's coffers, and requesting two commercial banks to lend the balance to settle NOC's bill. MOF's intervention resolved the immediate financial crunch faced by NOC and averted a petroleum supply crisis, but NOC is still not out of the woods. The NOC continues to lose millions of rupees every day under the current pricing mechanism.

[1](#)3. (SBU) Rameshwor Khanal, Joint Secretary, MOF told EmbOff that MOF came to NOC's rescue after most commercial banks refused to pledge any new loans to NOC, despite requests from Assistant Finance Minister Roop Jyoti. Umesh Prasad Dahal, Marketing Director of NOC, told EmbOff that, as of September 28, NOC's outstanding loans owed to banks and financial institutions had exceeded the equivalent of USD 46.8 million. Dahal added that NOC was forced to add new loans of approximately USD 21 million every month in order to meet losses from the sale of petroleum products and make payments on bank loans and interest. NOC already owed approximately USD 21 million combined to Nabil Bank and Rastriya Banijya Bank, two of Nepal's largest banks. Suresh Kumar Agarwal, Director of Distribution for NOC, informed us that, due to the government's subsidy of prices, the NOC incurred a loss of roughly USD 7 to 10 million every month. According to media reports, NOC lost more than USD 112 million last year alone.

CHANGING THE PRICING MECHANISM A MUST

[1](#)4. (SBU) Steady increases in the price of petroleum products in the international market, and the rapidly rising consumption of petroleum products in Nepal, have further amplified Nepal's loss. According to Dahal, HMGN should allow NOC to apply market-based pricing on petroleum products. With the current losses, NOC would soon be forced to shut, Dahal predicted. According to Harendra Bahadur Shrestha, President of Nepal Consumers' Forum, the price of petroleum products should be regularly adjusted based on international price fluctuations. Former Finance Minister Ram Saran Mahat opined to us that the only long-term solution was to develop a market-based pricing mechanism for petroleum products. HMGN had proposed a plan whereby NOC would import

petroleum products as far as the border, and the private sector would then take over and distribute the products; however, this plan suffered a blow when petroleum dealers criticized it as "raw" and refused to participate. HMGN was reportedly revising its proposal.

COMMENT

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15. (C) Determination of the price of petroleum products has always been a sensitive political decision in Nepal, weighing the public's reaction to a price increase. However, HMGN's policy of subsidizing prices, especially in light of soaring world oil prices, has caused huge losses to NOC. HMGN now faces the choice of immediately increasing the current prices and developing a cost-based pricing mechanism further inciting the public, or facing an economic crisis that could cause HMGN great difficulty. The political and economic costs to Nepal will only continue to rise as world oil prices increase.

MORIARTY